

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:FIP:B02

PLR-126338-10

Date:

November 15, 2010

Legend:

Taxpayer =

LP 1 =

LP 2 =

Mall =

City =

Lessee =

Facility =

Date 1 =

State =

Agreement =

Commission =

Law =

a =

b =
c =
d =
e =
f =
g =
h =
i =
i =

Dear :

This is in reply to a letter dated June 22, 2010, requesting a private letter ruling on behalf of Taxpayer. You have requested rulings that: 1) Taxpayer's receipt of percentage rent derived by the Lessee from the Premises related to certain gaming revenues, as calculated under a ground lease, will not be treated as being based upon the income or profits of any person within the meaning of section 856(d)(2)(A) of the Internal Revenue Code and section 1.856-4(b)(3) of the Income Tax Regulations; and 2) Taxpayer's receipt of percentage rent under the ground lease will qualify as "rents from real property" for purposes of section 856(c)(2)(C) of the Code.

Facts:

Taxpayer is a self-administered and self-managed publicly traded real estate investment trust (REIT) engaged in the ownership, operation, management, leasing, acquisition, expansion, and development of real estate properties including regional malls and community shopping centers. Taxpayer owns, directly and indirectly, more than a percent of the outstanding units of LP 1, a domestic limited partnership through which Taxpayer owns, operates, and develops real estate properties. LP 1 has a b percent interest in LP 2, which owns and operates a shopping center known as Mall, in City.

LP 2 is negotiating a ground lease with Lessee, a limited liability company, whereby approximately c acres (the Property) will be leased to Lessee. Lessee desires

to construct and operate a Facility on the Property, which is part of the Mall. On Date 1, Lessee submitted a proposal to State officials requesting a license for the Facility. In connection with its submission, Lessee entered into the Agreement with LP 2. The Agreement established the parties' agreement to enter into a ground lease of the Property, on which Lessee would construct a Facility and a multi-level parking structure upon the award of a license for the Facility by the State.

Under the ground lease, Lessee will pay LP 2 the sum of (i) a minimum annual rental payment of d dollars, which will be increased by e percent each year, and (ii) percentage rent. The percentage rent consists of (i) e percent of the annual gross revenues derived solely from "Retail Sales" at the Premises, plus (ii) e percent of the annual gross revenues received from "Gaming Revenues," less the "Percentage Rent Allowance".

"Retail Sales" is defined as the receipts, subject to certain adjustments, of all goods and merchandise sold, the charges for all services performed, or any other revenues generated by Lessee or any other person or entity in, at, or from the Premises for cash, credit, or otherwise (without reserve or deduction for uncollected amounts), but excludes any Gaming Revenues.

"Gaming Revenues" includes amounts received by Lessee from patrons at the Premises for video lottery terminal (VLT) gaming, less refunds, free promotional play (in the form of credits given by the video license and used by players to bet in a VLT) provided to the customers and invitees of Lessee pursuant to a rewards, marketing and/or frequent users program (generally referred to as "comps") and amounts returned to patrons through winnings, but without reduction for any casino operating expenses or gaming taxes.

The "Percentage Rent Allowance" is f dollars per annum, which will be allocated quarterly as the "Quarterly Allowance" of g dollars. Upon determination of the amount that is e percent of the Gaming Revenues and Retail Sales for each quarter, Lessee shall be entitled to deduct the Quarterly Allowance (prorated for any partial reporting period at the commencement and termination of the term of the ground lease) from the Gaming Revenues percentage rent and Retail Sales percentage rent to determine the percentage rent due under the ground lease for a reporting period. If there is an unused balance of the Quarterly Allowance at the end of a reporting period, the unused portion of the Quarterly Allowance shall be added to the next Quarterly Allowance for purposes of determining percentage rent.

All VLTs, associated equipment, and software at the Facility will be owned or leased by the Commission. The Commission will provide an oversight role at the Facility and will receive an initial license fee of h dollars from Lessee for the i year term of the license.

All "Proceeds" from the operation of the VLTs, which are defined as the part of the amount of money bet through VLTs that is not returned to winning players but is otherwise allocated under the Law exclusive of comps, are required to be electronically transferred by Lessee daily to a State fund. State will then pay Lessee, as licensee of the Facility, j percent of the Proceeds.

Law and Analysis:

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income must be derived from, among other sources, "rents from real property." Section 856(c)(3) provides that at least 75 percent of a REIT's gross income must be derived from, among other sources, "rents from real property."

Section 856(d)(1) provides that "rents from real property" include (subject to exclusions provided in section 856(d)(2)): (A) rents from interests in real property, (B) charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated, and (C) rent attributable to personal property leased under, or in connection with, a lease of real property, but only if the rent attributable to such personal property for the taxable year does not exceed 15 percent of the total rent for the taxable year attributable to both the real and personal property leased under, or in connection with, such lease.

Section 856(d)(2)(A) provides that rents from real property do not include any amount that depends in whole or in part on the income or profits derived by any person from the property, except that any amount so received or accrued shall not be excluded from rents from real property solely by reason of being based on a fixed percentage or percentages of receipts or sales.

Section 1.856-4(b)(3) of the regulations provides that where in accordance with the terms of an agreement an amount received or accrued as rent includes both a fixed rental and a percentage of all or a portion of a lessee's income or profits, neither the fixed rental nor the additional amount will qualify as rents from real property. Furthermore, an amount will not qualify as rents from real property if, considering the lease and all the surrounding circumstances, the arrangement does not conform with normal business practice but is in reality used as a means of basing the rent on income or profits.

Under section 1.856-3(g), a REIT that is a partner in a partnership is deemed to own its proportionate share of each of the assets of the partnership and to be entitled to the income of the partnership attributable to that share. For purposes of section 856, the interest of a partner in the partnership's assets is determined in accordance with the partner's capital interest in the partnership. The character of the various assets in the hands of the partnership and items of gross income of the partnership retain the same character in the hands of the partners for all purposes of section 856.

Gaming is a specialized industry whose normal business practices are unique to that industry. The American Institute of Certified Accountants guidelines (the Guide) on gaming provide that gaming revenues are based on “gross revenues” as defined under audit and accounting guidelines specifically for purposes of the gaming industry. These guidelines state that:

Revenue recognized and reported by a casino is generally defined as the win from gaming activities, that is, the difference between gaming wins and losses, not the amount wagered. . . . Promotional allowances (complimentaries, or comps) represent goods and services, which would be accounted for as revenue if sold, that a casino gives to customers as an inducement to gamble at that establishment. The cost of providing promotional allowances is included in costs and expenses. . . . The retail amount of promotional allowances is often disclosed in the financial statements. This disclosure, if made, is preferably made in the financial statement notes. However, the retail amount of promotional allowances may be included in the gross revenues and offset by deducting it from gross revenues on the face of the income statement. The retail amount of promotional allowances should not be included in gross revenues and charged to operating expenses because that would overstate both revenues and expenses.

AICPA Audit and Accounting Guide – Casinos (with conforming changes as of May 1, 2006), at Sections 2.03 – 2.04.

In the present case, Lessee is entitled to a percentage of gaming “Proceeds” from State that are electronically transferred directly from Lessee to State. Taxpayer, in turn, is a partner in a partnership (LP2) that is entitled to rents from Lessee based, in part, on “Gaming Revenues,” with adjustments as described above. The rents are paid directly from State to LP2 out of the Proceeds State collects from Lessee. As described in the Guide, determining gross proceeds from the VLTs to include only that part of a wager that is not returned to the patrons, exclusive of winnings and promotional allowances paid for by the casino to induce players to bet on the VLTs, is consistent with normal business practice in the gaming industry. In addition, State owns and maintains the VLTs, and controls payment of the Proceeds allocable to both Lessee and LP2. Finally, neither the Proceeds nor the rents based on Gaming Revenues may be reduced by casino operating expenses or gaming taxes. Therefore, based on the unique nature of the gaming business, no part of the percentage rent paid by Lessee to LP2 on the proceeds from the VLTs should not be considered as being based on the

income or profits of Lessee from the Facility, but rather should be considered as based on a fixed percentage of receipts or sales within the meaning of section 856(d)(2)(A).

Accordingly, because the rent received by Taxpayer is treated as determined based on a fixed percentage of receipts (proceeds) as allowed under section 856(d)(2)(A), rent Taxpayer derives from the Gaming Revenues will not cause amounts received under the ground lease to be treated as other than rents from real property under section 856(c)(2)(C).

No opinion is expressed or implied as to the federal tax consequences of this transaction under any provision not specifically addressed herein. Furthermore, no opinion is expressed concerning the treatment under sections 856(c)(2) or (3) of any revenues received by Taxpayer under the ground lease that are not specifically discussed above. Also, no opinion is expressed concerning whether Taxpayer otherwise qualifies as a REIT under subchapter M, part II of Chapter 1 of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

By: David B. Silber
David B. Silber
Chief, Branch 2
Office of Associate Chief Counsel
(Financial Institutions & Products)